United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

ORIGINAL

75-5005

To be argued by
SAMUEL J. WARMS

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Case No. 75-5005

In the Matter

-of-

AVIEN, INC.,

Debtor.

THE CITY OF NEW YORK,

Appellant,

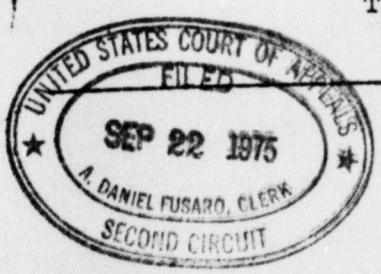
-against-

AVIEN, INC.,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE EASTERN DISTRICT OF NEW YORK

REPLY BRIEF OF APPELLANT THE CITY OF NEW YORK



W. BERNARD RICHLAND,
Corporation Counsel,
Attorney for Appellant,
The City of New York,
Municipal Building,
New York, New York 10007.
Telephone No. 566-3327

SAMUEL J. WARMS,
RAYMOND HERZOG,
CORNELIUS F. ROCHE,
of Counsel.

TABLE OF CONTENTS

Cases Cited

Statutes Cited

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Case No. 75-5005

In the Matter

-of-

AVIEN, INC.,

Debtor,

THE CITY OF NEW YORK,

Appellant,

-against-

AVIEN, INC.,

Appellee,

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NEW YORK

REPLY BRIEF OF APPELLANT THE CITY OF NEW YORK

(1)

In its answering brief (pp. 5-6), appellee cites an opinion of the New York Supreme Court, Appellate Division, Matter of Graham v. State Tax Commission, 48 AD 2d 444, 369 NYS 2d 863 (3d Dept., 1975), for the proposition that reference to I.R.C. §172 in the net operating loss

provision of a state income tax law does not require strict conformity with the federal return but rather is for use of that section only as a guide and a statement of general principles.

We have demonstrated in our principal brief (pp. 27-36) that e[illegible] if this were so, those general principles and guidelines nevertheless require the use of loss years in their chronological order and that those principles and guidelines do not permit the random choice of qualifying years to make up the net operating loss deduction. The Graham case involved a provision of the New York State personal income tax on nonresidents. New York imposes a personal income tax on its residents and also on nonresidents who have income from sources within New York (Tax Law, Art. 22). The tax on residents is based on federal adjusted gross income and deductions, both of which are appropriately modified (id., §612 and §615).

The New York State tax on the personal income of nonresidents, however, is limited to income and deductions from New York sources (id. §§631-635).* Accordingly, it provides a different treatment for the net operating loss deduction in order to isolate or apportion that part of the federal net operating loss deduction ascribable

* The City has no analogous tax on nonresidents, but a nonresidents' earnings tax on wages and self-employment income instead. See American Commuters Association v. Levitt, 405 F. 2d 1148 (2nd Cir., 1969).

to New York sources. The provision of the New York statute involved [Tax Law §632(b)(3)] reads, in pertinent part, as follows:

> "Deductions with respect to * * * net operating losses shall be based solely on income, gain, loss and deduction derived from or connected with New York sources, under regulations of the tax commission, but otherwise shall be determined in the same manner as the corresponding federal deductions."

The Graham case concerned a nonresident whose business activities in New York resulted in a net operating loss, but who had no federal net operating loss deduction in the year involved because operating profits from non-New York sources were sufficient to compensate for the New York loss. The Court held that the statute permitted the deduction of the New York net operating loss. In doing so, it declared a regulation of the State Tax Commission [20 NYCRR §131.6(c)], which limited the net operating loss deduction to the amount of the taxpayer's federal deduction, to be invalid.

The decision is not at all pertinent to the case at bar. While it is true that it permits a net operating loss deduction where there is no such federal deduction for the same taxable year, it does this because specific statutory verbiage dictates such a result. That verbiage does not bear more than linguistic resemblance to that of the statute involved in this case. Indeed, by using the phrase "determined in the same manner as" instead of

"the same as", it demonstrates that the last phrase means, as we contend, what it so clearly says.

The New York tax on nonresidents is designed to determine that part of the taxpayers' net income which is ascribable to New York sources. In doing so, it cannot practically isolate that net income without a rational method of extracting from the whole, that portion which it may reasonably ascribe to New York. Since it includes income in addition to and other than that from the operation of a business (e.g., rents, wages, trust income, etc.), it cannot employ an overall allocation formula like those provided by the General Corporation Tax Law with which we are concerned (Admin. Code §R46-4.0) and its state counterpart (N.Y. Tax Law § 210), which are applied to the entire net income of a taxpayer from sources both in and out of the state to arrive at a tax base. [Cf. Tax Law §632(c)]. Nor can it reasonably provide for a net operating loss deduction equal to the federal net operating loss deduction for it would be manifestly unfair to the fisc to permit a deduction of losses incurred in activities both within the state and in other states, from income generated only within the state and equally unfair to the taxpayer, in a case like Graham, to reduce the New York loss by inclusion of net profits from out-of-state sources.

Instead, N.Y. Tax Law §632(b)(3) provides for a deduction for net operating losses "derived from or

connected with New York sources * * * but otherwise shall be determined in the same manner as the corresponding federal deductions." Because of its very isolation or localization, such a deduction cannot possibly be "the same as" the federal loss deduction when the taxpayer operates in New York and other states.

The Graham case, therefore, lends no support to appellee's position in the instant case, for it involves the construction of an entirely different statute, a statute differently worded, differently conceived, differently designed and differently applied.

On the contrary, the Graham case supports our argument because the statute with which it deals, in nicely chosen language, calls for what appellee and the Court below interpret the statute involved in our case to call for, namely, application of the principles of I.R.C. §172; i.e., "the same manner" employed by I.R.C. §172, for general guidance. Thus, it demonstrates that when the legislature finds it necessary and intends to advert to a provision of federal law like I.R.C. §172 as a guide, it can do so by using precise, appropriate and clear language and that had it meant to do so in our case it would have used language similar to that of N.Y. Tax Law §632(b)(3) instead of the phrases "the same as the taxpayer's federal taxable income" and "the same as the net operating loss deduction allowed under section one hundred seventy-two * * *."

(2)

In support of its argument that those two phrases nevertheless permit deviation from the federal figures, the appellee quotes from the portion of Judge PARENTE'S opinion (50a-51a) in which he cites American Can Company v. State Tax Commission, 37 A D 2d 549, 323 NYS 2d 6 (3d Dept., 1971).

Ironically, the American Can Company case upheld the very same kind of adjustment of the federal loss deduction which was made in this case, a deviation dictated by the analogous state statute. For in deciding the only issue in the case, the Court excluded from the taxpayer's federal operating loss deduction the amount of an operating loss of a corporation which had been merged with the taxpayer, because that loss had been incurred prior to merger when the corporation was a wholly owned subsidiary not doing business in New York and not subject to the New York tax.

(3)

In our principal brief (p. 40), we took pains to point out that we were not trying to avoid the extra auditing and examining that the decision under review would entail. We did this because the Court below appeared to misunderstand the purpose of our discussion of that auditing and examination, as an aid to construction of the City statute.

Appellee chooses to persist in that misunder-

standing and to ignore the purpose of the point we tried to make. Instead of attempting to negate our reasoning, our brief is subjected to a psychoanalytic study which concludes, despite our protestations, that "the City's real concern" is "the City's fear that adoption of the debtor's contention would require the City to undertake a 'vast [sic]* program of enforcement and audit'" (Appellee's br., pp. 3-4, 8).

Even if this purported analysis in depth were accurate, our point would still be a valid one, supporting the construction of the statute which we urge.

(4)

After we filed our principal brief, the opinion in a case decided by a New York appellate court, Telmar Com. v. Procaccino, 48 AD 2d 189, 369 NYS 2d 208 (3d Dept., 1975), bearing on the question presented by this appeal, appeared in the official reports. Although not in point, the opinion does state that the net operating loss deduction provision of the state franchise tax law "is plainly intended to conform operating loss carryback and carryover practices with Federal law * * *" (48 AD 2d at p. 191). The Court in that case, unlike the Court below in this case (61a-62a), also interpreted the phrase "allowed under section one hundred seventy-two of the internal revenue

* Our brief (p. 38) spoke of "an extensive program of enforcement and audit."

code * * *" to mean "actually 'allowed'" (ibid.).

The opinion also pointed out that the taxpayer's argument was "directly contrary to the interpretation placed upon" the statute by the State Tax Commission (48 AD 2d at pp. 191-192), as in the appellee's argument in this case (see our principal brief, p. 36), and that "[t]hat construction is entitled to great weight by the courts * * *" (48 AD 2d at p. 192).

(5)

We should also like to cite, in support of our position (principal br., pp. 27-35) that losses must be carried to other years in chronological order of their occurrence, the United States Tax Court's decisions in Prichard Funeral Home, Inc., 21 TCM 1399, Dec. 25, 742 (M), TC Memo 1962-259 (Nov. 5, 1962) and Ellery W. Newton, 57 TC 245 (1971).

(6)

Several errors appear in our principal brief. On page 3, the word "arrangement" is misspelled as "arraignment". In the fifth line of the footnote appearing on page 26, the reference to "pp. 8-9" of that brief should be to pp. 11-12.

CONCLUSION

The order of the District Court and that of the Bankruptcy Judge reducing the tax claim of the City should be reversed and the claim allowed in full.

September 19, 1975

Respectfully submitted,

W. BERNARD RICHLAND,
Corporation Counsel,
Attorney for Appellant,
The City of New York,
Municipal Building,
New York, New York 10007
Telephone No. 566-3327

SAMUEL J. WARMS,
RAYMOND HERZOG,
CORNELIUS F. ROCHE,

of Counsel.

Amicus

AFFIDAVIT OF SERVICE ON ATTORNEY BY MAIL

State of New York, County of New York, ss.:

Carlos M Rodriguez being duly sworn, says that on the 22 day of Sept 1975, he served the annexed Reply Brief of Appellant upon Jules V. Spearner Esq., the attorney for the Nat Lehrman herein by depositing a copy of the same, inclosed in a postpaid wrapper in a post office box situated at Chambers and Centre Streets, in the Borough of Manhattan, City of New York, regularly maintained by the government of the United States in said city directed to the said attorney at No. 45 North Salwn Ave in the Borough of Great Neck, City of New York, being the address within the State theretofore designated by him for that purpose.

Sworn to before me, this 22 day of Sept 19 75

John Calia

JOHN CALIA
Notary Public, State of New York
No. 41-5573955 Queens County
Certificate Filed in New York County
Commission Expires March 30, 1976

Carlos M Rodriguez

Form 323-50M-721047(72) 346